



STATE OF WASHINGTON
GAMBLING COMMISSION

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IMPACTS OF INITIATIVE 892

This information is provided for analytical purposes only and is not intended as an expression of support for or opposition to the proposed Initiative.

Brief Summary of I-892¹:

Initiative 892 (I-892) authorizes the same number and type of electronic scratch ticket machines as tribal casinos with a portion of the revenue generated used to reduce property taxes. The Washington State Lottery (WSL) would allocate, regulate, distribute, and license the machines, not the Gambling Commission. A machine applicant must have a valid license from WSGC for six months consecutively preceding getting an electronic scratch ticket (EST) license.

How many machines an operator would receive is based on their size and type of license they currently hold.

Impacts:

- 1) Would authorize 18,225 electronic scratch ticket machines (machines) in approximately 2,040 locations that they are not in now (including approximately 90 house-banked card rooms, 1550 commercial pull-tab businesses, 400 charitable/nonprofit bingo and/or pull-tab operators, and Emerald Downs). Although limited by the total allocation of machines, under the terms of the Initiative, approximately 6,600 other food and drink businesses licensed by the Liquor Control Board could be eligible for a machine license in subsequent years; the growth potential is unknown. The Tribes began operating machines in 1999 and currently operate about 16,000 in the 23 tribal casinos in the state.

¹ With the exception of the provisions dealing with property taxes, I-892 appears to be patterned after HB 2282, which was proposed during the 2003 legislative session. This bill would have allowed electronic scratch ticket machines, operated by the Washington State Lottery. HB 2282 was very similar to HB 1948, which was proposed by the Entertainment Industry Coalition; under HB 1948, the Gambling Commission would have licensed and regulated the machines. The Gambling Commission, along with several other agencies, was asked to provide a fiscal note for HB 1948, but not for HB 2282.



- 2) Would result in two regulatory systems for machine gambling in the state: one for Tribes and one for electronic scratch ticket machine licensees. The Tribes are regulated by three agencies: the Gambling Commission; federal National Indian Gaming Commission; and each Tribe's Tribal Gaming Agency. EST machines would be regulated by one agency: the Lottery Commission.
- 3) Having two agencies doing similar work may lead to:
 - Duplication of efforts with licensing and regulation of machines
 - Inconsistency if the two agencies set different standards for licensing, testing, and regulation
 - Requests by Tribes to change the Compacts to decrease the current regulation required (for example, surveillance) and/or the regulatory structure
- 4) Information obtained by WSGC pursuant to background checks would be provided to WSL. There may be some legal issues with this that would need to be addressed prior to instituting an information exchange. Briefly, the Lottery Commission and the Gambling Commission are both limited jurisdiction criminal justice agencies and as such may be able to exchange criminal history information maintained by the Washington State Patrol. However, national criminal background information provided by the Federal Bureau of Investigation (FBI) to any agency may only be shared with other agencies with the statutory authority to receive such information. In 2002, the Legislature amended RCW 9.46.070, at the Gambling Commission's request, to provide clear authority for the agency to receive national criminal background information. At this time, it does not appear that the Lottery Commission has such authority. Information from the FBI indicates that the Gambling Commission could be in violation of federal law (28 CFR 50.12) if it shared FBI information with the Lottery Commission.
- 5) Complicates local governments' ability to prohibit machines. Currently, local governments may completely prohibit gambling activities, such as card rooms, pull-tabs, and bingo. Local governments cannot prohibit Lottery activities. Because an EST licensee must have a license issued by the Gambling Commission to qualify for the machine license, local jurisdictions could only prohibit machines indirectly by prohibiting the underlying activities (pull-tabs, bingo, and card rooms).

Prohibiting these underlying activities would likely translate into a loss of gambling tax revenue for local governments. In fiscal year '04, licensees reported paying just over \$45 million in gambling taxes to local governments.
- 6) One percent of the state excise tax (after reasonable administration expenses for the Lottery Commission are deducted) would be for problem gambling and DSHS would be required to contract with a nonprofit organization to address problem gambling and implement a treatment program. Requiring DSHS to contract with

a nonprofit organization may take away flexibility and discretion in the event there are better ways to address problem gambling issues (See Attachment #1 for flowchart of how revenue would be distributed).

Financial:

- 7) Based on the experience of other states when machines were introduced, we anticipate that with the authorization of these machines, there will be a decrease in gross receipts for other gambling activities, particularly pull-tabs and bingo. WSGC's revenue is collected through license fees, which are based primarily on gross receipts. As a licensee's gross receipts decrease, the license fee decreases. Therefore, if licensees' gross receipts decrease, WSGC's revenue will also decrease. Pull-tab license fees are the largest source of revenue for the Commission.
- 8) With a phase-in of machines, we anticipate revenue would decrease by 5% in fiscal year 06 from current estimates, 90% in fiscal year 07 (this is due, in part, because of class reduction refunds), and 50% in fiscal year 08 (See Attachment #2). As a non-appropriated agency, which does not receive revenue from the state general fund, this decrease would necessitate reducing staff by 40%, or approximately 70 employees (from 167 employees to 98). Most of these reductions would need to occur in fiscal year 06.
- 9) A decrease in revenue may not create an equal decrease in the agency's work. Because a machine licensee must have a license from the Gambling Commission, we anticipate that machine licensees will change their current licenses for pull-tabs and bingo to licenses that allow lower gross receipts levels. However, the need for the following regulatory and investigative work will remain:
 - Licensing investigations, including tracing the funds used in the business and conducting criminal background checks. Because a machine licensee cannot allow their Gambling Commission license to lapse or they will lose their allocation of machines, we anticipate an increase of complicated ownership cases; we may also see cases involving the concealment of unqualified owners or hidden ownership.
 - Regulatory work for the other authorized activities (pull-tabs, bingo, and card rooms), including responding to complaints from the public.
 - Requests to investigate machine-related criminal activities, such as cheating or tampering with the EST machines. Unlike current lottery activities, EST machines will be in locations also regulated by the Gambling Commission. As a law enforcement agency we anticipate we, rather than local law enforcement, would be asked to investigate and enforce the criminal laws in the Gambling Act, including those related to cheating.

- 10) I-892 allows the state to tax the revenue from the machines, but local governments cannot. If pull-tab and bingo activities decrease, gambling tax revenue collected by local governments will likely also decrease.
- 11) The limits on tribal casinos, including the number of machines, features of the machines (for example, no cash in or out), and hours of operation were based on the type and scope of gambling allowed in the state. I-892 would change this and would likely lead to requests for changes in the current Compacts.
- 12) If tribal revenue decreases, this could result in decreases of contributions required in the Compacts, which are based on a Tribe's revenue, including:
 - Community contributions currently made to local governments; and
 - Contributions made to charitable/nonprofit organizations.

Twenty-five percent of the agency's funding is from Tribes to reimburse the agency for licensing and regulation.

Allocation:

- The allocation method for machines for those with licenses issued by the Gambling Commission as of January 1, 2005, is:
 - 15% to bingo operators licensed as of January 1, 2005, who have the top 40 gross receipts (Maximum of 125 per location)
 - 36% to house-banked card rooms operating at least five house-banked tables and to horse racing facilities (Maximum of 125 per location)
 - 49% to commercial pull tab licensees and charitable/nonprofit organizations with bingo or pull-tabs (other than the top 40 bingo licensees)
 - The number of machines is based on annual gross gambling receipts; as the gross receipts increase, the allocation increases. Each location is guaranteed a minimum of four machines.
- Based on the allocation method and the number of licensees today, there would not be enough machines for each of these licensees to receive the maximum number (See Attachment #3). For example, based on staff's calculations, the "Top 40" bingo operators and house-banked card rooms would receive approximately 70 machines.
- The allocation method allows some licensees to receive more machines than other licensees. For example, a small pull-tab operator may operate only four machines, while another pull-tab operator nearby may operate 20. This same difference would exist for charitable/nonprofit organizations.

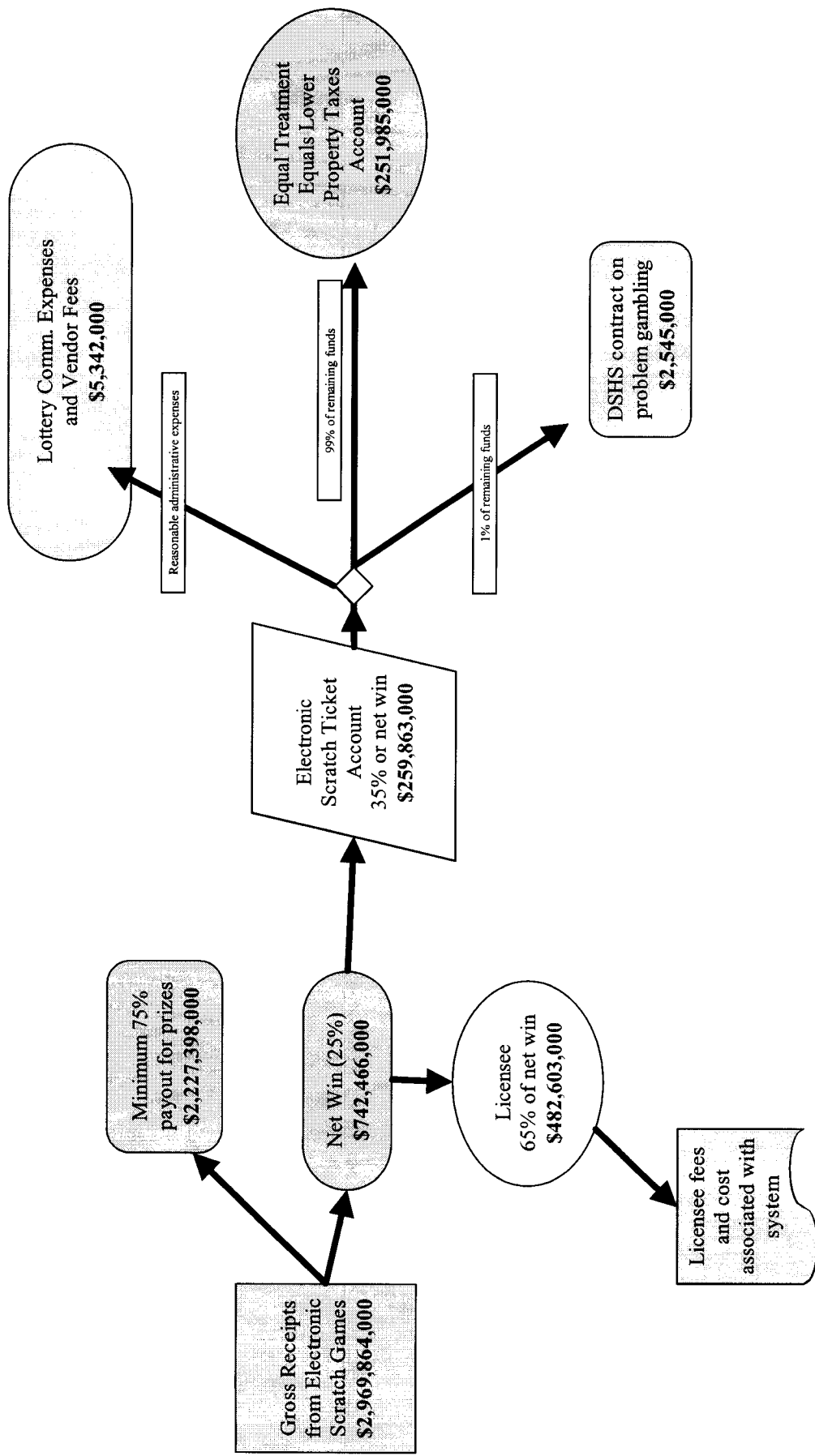
- More machines may become available through closures, either voluntary or through license revocations. More machines may also become available if there is an increase in the number of machines Tribes may operate. This could occur through the approval of another Compact or a change in the number of machines currently allowed for Tribes. According to the Initiative, if there are more applications than machines available, the Lottery would pass rules to address this.

Drafting:

- There are some drafting issues, making it difficult to determine how the Initiative would be interpreted and implemented.
 - Section 2 amends the Gambling Act to include several definitions; it seems the Lottery Act would need to be amended to include these as well.
 - Section 10, subsection (1) states that the Lottery *may* revoke an EST license if the licensee fails to maintain a WSGC license in good standing. It could lead to unintended results for this to be “permissive,” rather than required. This is difficult to reconcile with subsection (4), which states an EST licensee must maintain a valid license for six months prior to receiving an EST license. It’s also unclear whether a WSGC license is needed every year or only after the initial licensing for machines. We have assumed a valid WSGC license is required to be maintained continuously to have a machine license.

Other Provisions of Initiative 892:

- Imposes a 35% state excise tax on the net win (HB 1948 proposed a 20% state tax and 5% local tax; HB 2282 did not propose a tax per se, but the state would have received 40% of the net win)
- The minimum, required payout is 75%, which is the same as the tribal lottery machines. The price of the tickets shall not exceed the amount allowed for Tribes (in HB 2282 and HB 1948, the limit was \$5.00, which is the current limit for Tribes)
- 99% of the state excise tax (after Lottery expenses) would be used to lower the subsequent year’s state property tax
- Establishments must conspicuously display an estimate of the probability of purchasing winning tickets at the facility
- The number of machines a licensee could initially receive would be based on their gross receipts for 1999 through 2002, data available through WSGC records



Figures derived from Office of Financial Management
Potential Financial Impacts of I-892 - Table 1
 for Calendar year 2008

Projected Impact of I-892 on WSGC License Fee and ID Stamp Revenue

	Current FY06 Estimate	Estimated Impact of I-892 in:			If I-892 is Approved, Estimated Revenue in:		
		FY06*	FY07**	FY08***	FY06	FY07	FY08
License Fees:							
Gambling Activities -							
Punchboards/Pulltabs	\$4,621,438	(\$231,072)	(\$4,159,294)	(\$2,310,719)	\$4,390,366	\$462,144	\$2,310,719
House-Banked Card Rooms	\$2,163,080	(\$159,000)	(\$159,000)	(\$159,000)	\$2,004,080	\$2,004,080	\$2,004,080
Bingo Licenses and Managers	\$239,065	(\$11,953)	(\$215,159)	(\$119,533)	\$227,112	\$23,907	\$119,533
Amusement Games	\$280,354	(\$14,018)	(\$252,319)	(\$140,177)	\$266,336	\$28,035	\$140,177
Raffles	\$171,796				\$171,796	\$171,796	\$171,796
Public Card Rooms	\$22,375				\$22,375	\$22,375	\$22,375
Combination Licenses	\$14,884	(\$744)	(\$13,396)	(\$7,442)	\$14,140	\$1,488	\$7,442
Fund Raising Events	\$876				\$876	\$876	\$876
Social Card Rooms	\$3,744				\$3,744	\$3,744	\$3,744
Individuals and Provider Organizations -							
Public & HB Card Room Employees	\$1,376,732	(\$137,673)	(\$688,366)	(\$963,712)	\$1,239,058	\$688,366	\$413,019
Gambling Manufacturers & Rep.	\$146,006	(\$7,300)	(\$73,003)	(\$73,003)	\$138,706	\$73,003	\$73,003
Gambling Distributors & Rep.	\$89,358	(\$4,468)	(\$44,679)	(\$44,679)	\$84,890	\$44,679	\$44,679
Nonprofit Gambling Managers	\$34,630				\$34,630	\$34,630	\$34,630
Services Suppliers	\$76,441	(\$3,822)	(\$38,221)	(\$38,221)	\$72,619	\$38,221	\$38,221
Commercial Gambling Managers	\$938				\$938	\$938	\$938
Linked Bingo Prize Provider & Rep.							
License Fees Total	\$9,241,717	(\$570,050)	(\$5,643,435)	(\$3,856,485)	\$8,671,666	\$3,598,281	\$5,385,231
Other Sources							
I.D. Stamps (PB/PT & Bingo)	\$617,486	(\$30,874)	(\$308,743)	(\$308,743)	\$586,611	\$308,743	\$308,743
Charges for Investigations, Manu. Audits	\$188,600				\$188,600	\$188,600	\$188,600
Class III Employee Certifications	\$1,395,024				\$1,395,024	\$1,395,024	\$1,395,024
Class III Gaming Regulation	\$1,409,000				\$1,409,000	\$1,409,000	\$1,409,000
Electronic Gaming Lab Charges	\$370,500				\$370,500	\$370,500	\$370,500
Fines and forfeits, Prob Gam Fee, etc.	\$568,000				\$568,000	\$568,000	\$568,000
Other Sources Total	\$4,548,610	(\$30,874)	(\$308,743)	(\$308,743)	\$4,517,736	\$4,239,867	\$4,239,867
TOTAL =	\$13,790,326	(\$600,925)	(\$5,952,178)	(\$4,165,228)	\$13,189,402	\$7,838,148	\$9,625,099

Attachment # 2

NOTES:

* According to information published by OFM, the Lottery assumes that 500 machines could be in place by January, 2006 and 13,100 machines (72% of those allowed) by July, 2006. Because of this, we estimate that there should be no impact on our non-House Banked Card Room (HBCR) organizational licensees' gross receipts until January, 2006. Because license fees for each ensuing year are based upon the previous year's gross receipts, it is estimated that impact on FY06 licensing revenue will be minimal (licensees renewing in June would experience an estimated drop in gross averaging 15% from January through June, 2006). We estimate a 5% reduction in license revenue for FY06. For HBCR, it is estimated that licensees will quickly migrate to either 11 tables (in order to operate 3 tables at the higher \$200 betting limits) or 5 tables (to qualify for the most machines possible), reducing the number of tables licensed by 200, dropping HBCR revenue by \$318,000/year beginning in January, 2006. As machines begin to be deployed, the number of licensed tables in operation will drop; for FY06, the number of card room employees is expected to drop 10%.

** The Lottery expects all 18,225 machines to be in operation by January, 2007. Gross receipts of our non-HBCR organization licensed activities will be significantly impacted by the novelty of machines and by their total numbers. We estimate that gross receipts for these activities will drop 50%, causing license fees to be reduced by about 50%. Because the WSGC refunds the portion of the previous license fee that is excess of the fee related to the gross receipts the licensee actually did over the license year, most refunds will be approximately the same as the license fee for the ensuing year. The result is that license fee revenue for FY07 will drop by 90% and be at 10% of the current FY06 level. With a decrease in HBCR tables and machines becoming more available in HBCRs, we expect a reduction of Card Room employees by 50% from the FY05 level (6,700). As gross receipts drop for licensed activities, the need for supplies (ID stamps), manufacturers, distributors and representatives for those businesses will also likely drop. We assume that reductions in ID stamps and licensed representatives will mirror drops in gross receipts for licensed activities.

*** The Lottery estimates that all machines will be in operation for all of FY08. Gross receipts of non-HBCR organization licensees are estimated to be at 50% of the pre-I-892 levels, and the refund issue will have worked through the system, with the result that license fees for impacted activities, ID stamps, and manufacturer and distributor representatives will be about 50% of pre-I-892 levels. As HBCRs fully implement machines, it is estimated that employee numbers will drop by 70% and be at 30% of the pre-I-892 level.

These estimates assume the machines will have a payout (net win) of about 90%, which is closer to the current payout of tribal machines. Should the electronic scratch ticket machines be programmed to payout the minimum 75% set forth in the initiative, the mid- to long-range impacts on WSGC licensees would be reduced, and impacts on license fee revenues would be less severe than those estimated here. We know that players respond to payout ratios, and while they will play machines for the novelty, it is expected that they would soon return to other forms of gambling (tribal machines, some pull tabs, etc.) that offer higher payout ratios.

Summary Table of I-892 Impacts on WSGC Revenues by Source:

	FY06	FY07	FY08
Organizations	-5%	-90%	-50%
Card Room Employees	-10%	-50%	-70%
ID Stamps, Manu. & Dist. Reps	-5%	-50%	-50%

Attachment # 2

Estimated Staffing Consequences of I-892 Impacts on WSGC Revenue

The revenue consequences of I-892 shown above, given the way the WSGC currently handles refunds, suggest little impact in FY06 and significant impact in FY07, followed by an increase to a more steady level in FY08. In order to avoid depleting working capital in the lean FY07, we would have to make staffing adjustments in FY06 to the level of staffing that can be supported in FY08.

The Commission's current approved budget level for FY06 is \$13,980,000 and 167.5 FTEs.

FY08 Shortfall = (\$4,165,228)	
Average cost per WSGC position =	\$60,000 (An average agent costs \$70,000 which includes salaries, benefits, supplies, travel, etc.) (An average non-agent employee costs \$50,000 which includes salaries, benefits, supplies, travel, etc.)
Number of positions to be reduced =	69.4 (Assumes positions evenly distributed among agents and non-agents)

FTEs in Commission Budget for FY06 =	167.5
FTEs remaining after I-892 =	98.1
Percentage reduced =	41.4%

WSGC Analysis of Machine Allocation as Provided by I-892

	Number of Active Licensees ¹	Maximum Machines Allowed	Machines allocated if there were no total limit on number of machines	% of available machines allocated to group	Machines available within group	% of maximums allowed available for licensees	Average machines per licensee	Machines allocated to each licensee ⁴	Total Machines Allocated ⁵
Top 40	40	125	5,000	15%	2,734	55%	68.35	68	2,720
HBCR (5 or more tables) and Emerald Downs	92	125	11,500	36%	6,561	57%	71.32	71	6,532
All others (by Gross Receipts)				49%	8,930	91% ³			
0-\$200K ²	985	4	3,940		3,940		4.00	4	3,940
\$200K - \$300K	221	5	1,105		1,014		4.59	4	884
\$300K - \$400K	146	6	876		804		5.50	6	876
\$400K - \$500K	93	7	651		597		6.42	6	558
\$500K - \$600K	68	8	544		499		7.34	7	476
\$600K - \$700K	35	10	350		321		9.17	9	315
\$700K - \$800K	33	12	396		363		11.01	11	363
\$800K - \$1M	35	14	490		449		12.84	13	455
\$1M - \$1.25M	20	16	320		294		14.68	15	300
\$1.25M - \$2M	29	18	522		479		16.51	17	493
\$2M - \$2.5M	7	20	140		128		18.35	18	126
\$2.5M - \$3M	1	22	22		20		20.18	20	20
\$3M and up	1	24	24		22		22.01	22	22
All Others Sub-Tot =	1,674		9,380		8,930				8,828
Totals =	1,806		25,880	100%	18,225				18,080

Notes: This is one way in which machines might be allocated. The agency implementing this may have to pass rules to clarify parts of the allocation process.

¹ Licensees were selected from the database as of October 4, 2004. "All others" are categorized based upon their highest grossing year of the four years beginning 1999. The number and distribution of licensees is subject to change.

² The Initiative guarantees a minimum of 4 machines to a licensee.

³ To calculate machines available to all but the smallest licensees, the number of machines guaranteed them is subtracted from the total available to the group and all other licensee categories are then allocated 91% of their maximum allocations.

⁴ Under the Initiative, no "Top 40" or HBCR licensee can be allocated more than the arithmetic average for their category. Allocations are rounded for "All Others" (except for the \$200K-\$300K category, where rounding would cause more total machines to be allocated than are available).

⁵ It is unclear whether the remaining 145 (18,225 - 18,080) machines would be allocated to the "All Others" category.